

EMPLOYEE ABUSE PREVENTION ACT OF 2002 (DURBIN-DELAHUNT)
(S. 2798 / H.R. 5221)
SECTION-BY-SECTION SUMMARY

OVERVIEW

The Employee Abuse Prevention Act of 2002 is a package of reforms of the Bankruptcy Code designed to protect employees and retirees from corporate practices that rob them of their earnings and retirement savings when businesses collapse into bankruptcy.

The bill does this in two ways. *First*, it empowers the courts and trustees in bankruptcy to challenge transactions that have stripped assets from the company and to recapture those assets for the benefit of the company and its creditors (title I). *Second*, it ensures that the claims of employees and retirees receive fair treatment vis-a-vis those of other creditors (title II).

SEC. 1. Short Title; Table of Contents. Provides that this Act may be cited as the "Employee Abuse Prevention Act of 2002".

TITLE I—PRESERVING CORPORATE ASSETS

SEC. 101. Federal fraudulent transfer amendments. Amends section 548 to enhance the ability of the bankruptcy court to scrutinize fraudulent transfers by (a) lengthening the period of review from one year preceding a bankruptcy filing to four years (the same reachback period provided under the Uniform Fraudulent Transfer Act as adopted in 36 states); and (b) empowering the court to review and recapture excess benefit transfers made to top management and other corporate insiders while the debtor was insolvent or as a result of which the debtor became insolvent.

The provision defines "excess benefit transfer" as a transfer or obligation to an insider or affiliate of the debtor in an amount that is at least 10 times greater than similar transfers made to or obligations incurred for the benefit of non-management employees (or, if no such transfers or obligations took place, then in an amount that is at least 25 percent more than the amount of any similar transfer made to or obligation incurred for the benefit of the insider or affiliate during the preceding calendar year).

This section seeks to recapture assets for creditors, employees and retirees, adding value to the bankruptcy estate by calling to account those who use the company for their personal benefit. By making excess benefit transfers to corporate insiders subject to set-aside and recovery if the company goes bankrupt, the provision also seeks to prevent corporate managers from engaging in these practices.

SEC. 102. Transparent characterization of transactions. Amends section 105(a) to clarify the court's authority to recharacterize as a secured loan a sale, lease, or other

transaction whose material characteristics are substantially similar to the characteristics of a secured loan.

This section seeks to affirm and reinforce the authority of the court to scrutinize transactions that move assets "off book" by permitting the court to look through the formalities of "sale" to determine whether, in fact, the transaction was a disguised loan against corporate assets. Once the transaction is seen for what it really is, the assets can be brought back into the estate for distribution to creditors, employees and retirees.

This section also seeks to deter transactions that are merely disguised forms of lending designed to drain assets from the business.

SEC. 103. Trustee as good faith reliance purchaser for value. Amends section 544(a)(3) to upgrade the status of the trustee in bankruptcy from that of a lien creditor to that of a "good faith reliance purchaser for value".

This section restores to trustees in bankruptcy the ability to review and set aside suspect transactions which they enjoyed as lien creditors under Article 9 of the Uniform Commercial Code prior to the UCC amendments that became effective on January 1, 2002.

SEC. 104. Limitation on retention bonuses, severance pay and certain other payments. Amends section 503 to enable the court to place reasonable limits on payments made to corporate insiders for the ostensible purpose of preventing them from leaving the bankrupt company.

This section prohibits retention payments (whether in the form of bonuses, compensation, or other benefits) unless the court finds that (a) the payment is essential to retention of the person because the person has a bona fide job offer from another business at the same or greater rate of compensation; (b) the services provided by the person are essential to the survival of the business; and (c) the amount of the payment is not greater than 10 times the amount of the mean payment of a similar kind given to nonmanagement employees (or, if no similar payments were made to nonmanagement employees, the amount of the payment is not greater than 25 percent of the amount of any similar payment made to the person during the preceding year).

The section also prohibits severance pay to insiders unless (a) the payment is part of a program that is generally applicable to all full-time employees; and (b) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made.

Finally, the section prohibits other payments that are outside the ordinary course of business (including payments made to officers, managers, or consultants hired after the date of the filing of the petition) which are not justified by the facts and circumstances of the case.

Taken together with the court's avoiding powers under sections 544, 547, 548, and 549 of the Bankruptcy Code, these provisions would empower the court to return excessive bonuses to the estate, where they would be available to help the company reorganize, or, in the alternative, for distribution to creditors.

SEC. 105. Limitation on avoidance of certain transfers. Amends section 546(e) to clarify an ambiguity in current law. Section 546(e) was enacted at the behest of the securities industry to prevent lawsuits against commodity brokers and securities clearing agencies who carry out certain transfers, such as margin payments and settlement payments, on behalf of their clients. Some courts have construed the provision to prevent recovery not only against these intermediaries but also against the ultimate shareholders on whose behalf the transfers are made. This section closes that loophole by clarifying that 546(e) protects only the intermediaries whom Congress intended to protect.

SEC. 106. Effective date. Provides that title I of the Act will take effect on the date of its enactment with respect to bankruptcy proceedings that are pending on or commenced before, on, or after the date of enactment.

TITLE II—ENHANCING THE TREATMENT OF EMPLOYEE CLAIMS

SEC. 201. Fair treatment of employee benefits. Expands the definition of "claim" under section 101(5) of the Bankruptcy Code to include a right or interest in equity securities of the debtor (or an affiliate of the debtor) contributed by the debtor to its employee pension plan (as defined by section 3(2) of the Employee Retirement Income Security Act of 1974 (ERISA)) for the benefit of an individual who is not an officer or director of the debtor. Under this provision, the plan beneficiary may assert a claim only to the extent that the terms of the plan do not permit the beneficiary to control the investment decision.

The provision also amends section 507(a)(4) to give the new claim a fourth priority among allowed unsecured claims, with the amount of the claim measured by the market value of the stock at the time it was contributed to, or purchased by, the plan.

This section provides a measure of protection to employees and retirees who are left holding worthless employer stock in their pension plans when the company goes bankrupt because they were not free to choose other investment options.

SEC. 202. Wage priority and employee benefit cap. Amends section 507(a) to raise from \$4,650 to \$13,500 the cap on priority claims for unpaid wages, salaries, or commissions and contributions to employee benefit plans.

SEC. 203. Enhanced treatment of claims arising from failure to meet fiduciary obligations toward employees and retirees. Amends section 503(b) to treat as allowed administrative expenses of the estate retiree claims arising from violations of the debtor company's fiduciary obligations to an employee pension plan under ERISA. The provision

then amends section 506 to provide that the plan or a beneficiary of the plan may recover any unpaid amount of such claims from any property securing an allowed secured claim. It should be noted, however, that this provision does not affect liens created prior to the date of enactment of the bill. Finally, the provision amends section 507(b) to give such claims priority over all other claims for administrative expenses.

By subordinating the claims of secured creditors to the claims of aggrieved pension plan beneficiaries, this section provides a measure of protection to retirees and creates an incentive for financial institutions to protect their collateral by requiring assurances that the company is living up to its fiduciary obligations.

SEC. 204. Enhanced review of pre-bankruptcy terminations of retiree benefits.

Amends section 1114 to provide that whenever retiree benefits have been modified within the 180-day period before the filing of a bankruptcy petition, the court shall appoint a representative to investigate such modifications and shall order reinstatement of the benefits if it finds that the modifications were made in contemplation of bankruptcy and were not essential to the continuation of the business of the debtor.

SEC. 205. Local filing of bankruptcy cases. Amends the "venue" provisions of section 1408 of title 28, United States Code, to prohibit corporate debtors from filing for bankruptcy relief in a district based solely on (a) the debtor's incorporation in the state where that district is located; or (b) the presence of a subsidiary or affiliate in that district. As amended, section 1408 would permit a debtor corporation to file only in the district in which its corporate parent has its principal place of business; or, if its corporate parent is not a debtor, in the district in which its affiliate with the greatest assets in the United States has its principal place of business (whether or not the affiliate is a debtor). The section also amends section 1412 of title 28 to provide that if a debtor corporation files in the wrong district, the court shall dismiss the case or transfer it to a district in which it could properly have been brought.

SEC. 206. Effective date. Provides that, except for section 203(b), title II of the Act will take effect on the date of its enactment with respect to bankruptcy proceedings that are pending on or commenced before, on, or after the date of enactment. Section 203(b), which permits recovery of unpaid claims from property securing an allowed secured claim, applies only to liens created on or after the date of enactment.